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Institutional Cost Contribution
Requirement for Competitive Products

Docket No. RM2012-3

COMMENTS OF THE PUBLIC REPRESENTATIVE IN RESPONSE TO NOTICE OF PROPOSED RULEMAKING TO EVALUATE THE INSTITUTIONAL COST CONTRIBUTION REQUIREMENT FOR COMPETITIVE PRODUCTS

(April 9, 2012)

Pursuant to Commission Order No. 1108, as supplemented by Order No. 1276[1], the Public Representative offers comments on the Commission's review of the institutional cost contribution requirement for Competitive Products.

Introduction

Section 3633(a)(3) of Title 39 required that competitive products collectively contribute an "appropriate share" of the institutional costs. This subsection left the determination of what constituted an "appropriate share" to the Commission. Additionally, Section 3633(b) requires the Commission to review this standard every five years after enactment of that section. The Commission originally set the minimum contribution at 5.5 percent.[2] In making the determination of the appropriate share the Commission noted that, among other factors, the historical institutional cost contributions of the products that would be included in the competitive products listing

[1] Order No. 1108 initially set a due date of March 5, 2012 for comments on this review. Parcel Shippers Association (PSA) subsequently requested a one year extension of the due date for comments and was supported in its motion by several parties, including the Postal Service. On March 7, 2012 the Commission issued Order No. 1276, which in part, granted the delay in filing comments, but only for slightly more than one month to April 9, 2012.
[2] Commission Order No. 43, Docket No. RM2007-1 at 90-92.

averaged between 5.4 and 5.7 percent over the previous two years. Additionally, setting the appropriate share at the outset of the new form of competitive rate regulation at this historical level would allow the Postal Service to perform as well as in the past.[3]

Performance of Competitive Products at 5.5 Percent Contribution

Since the implementation of the minimum appropriate share of institutional costs, competitive products have never failed to meet that threshold, indeed, it has consistently exceeded it. Beginning in FY 2007, as shown in the following table 1, the minimum actual contribution of competitive products has been at least 5.54 percent with a high of 7.82% in FY 2011.

Table I

Competive Product Share
Of Institutional Costs
FY 2007 - FY 2011

	Contribution to Institutional Costs	Adj. Contribution to Institutional Costs
FY 2007	5.66%	5.66%
FY 2008	5.54%	5.54%
FY 2009	6.78%	5.96%
FY 2010	7.12%	7.12%
FY 2011	7.82%	6.59%

Total institutional costs have fluctuated significantly during this time as the Congress had deferred payments to the Retiree Health Benefits Fund in FY 2009 and FY 2011. But even taking those deferrals into account and recalculating total institutional costs during those years, competitive products still have met or exceeded the minimum 5.5% contribution, as shown in the above table.

This has been especially true over the last two years, as competitive products volumes and revenues have grown over that period contrasted with the continued

[3] Commission Order No. 26, Docket No. RM2007-1 at 73-74.

volume and revenue declines in most market dominant products. Of course, it should be noted that the difference in the products for the two groups, mostly letter and flat shaped products for the market dominant group and parcels for the competitive products, are the primary reasons for the difference in performance over the last two years. The internet and changes in advertising resources have taken a toll on the two largest market dominant products, First-Class and Standard Mail. Yet, while the internet and electronic commerce has reduced volumes and revenues for those two products, it has been a primary driver in the recent volume and revenue increases in the parcel dominated competitive products. As more consumers use the internet to purchase merchandise and other services the more important it becomes for the Postal Service to be able to compete with other shippers to capture this growing segment of the retail market. In that vein the Postal Service has developed several new products within the competitive products grouping. Priority Mail's Flat Rate boxes are probably the best example of the Postal Service taking a long established product and adapting it to generate increasing volumes.

Additionally, the recent transfer of some First-Class mail parcels and Standard Mail parcels from the market dominant product list to the competitive product list will also enable the Postal Service to compete effectively.[4] The transfer of these products have increased the volume of competitive products by almost 50 percent and increased revenues by almost 20 percent.[5] However, little is known about the effects the transfer of these products will have on the costs of competitive products or its effect on the competitive products contribution to institutional costs.[6]

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[4] See Commission Order No. 689, March 2, 2011, Docket No. MC2010-36 and Commission Order No. 710, April 6, 2011, Docket No. MC2011-22.

[5] The monthly financial report for February, 2012 shows total competitive products volumes increasing 48.4% year to date over the prior year and revenues increasing 18.7% year to date over the prior year. In the first quarter of FY 2012, the new First-Class Package Services accounted for 70% of the total competitive products volume growth. Commercial Standard Mail parcels were transferred to the competitive product list as a lightweight subcategory within Parcel Select in the second quarter of FY 2012 as the transfer was conditional on the Postal Service filing notice of a competitive price change that would satisfy 39 U.S.C 3633(a) and 39 CFR part 3015 and that the transfer will be effective as of the effective date of the price change which was implemented on January 22, 2012.

[6] The Commission noted in Order No. 689 at 15 that the rates charged for Standard Commercial Lightweight parcels did not cover the costs attributable to those parcels.

So, by any standard of comparison, competitive products are probably the only growing part of the Postal Service's business. There are some, though, who would think that this would imply a change in the appropriate share contribution of competitive products, particularly an increase from the current 5.5% requirement.[7] The Public Representative believes that this is a rush to judgment and that, as shown in the following discussion, is entirely incorrect.

Uncertainty for the Future

Since the passage of the Postal Accountability and Enhancement Act (PAEA) the Postal Service has experienced significant financial losses. An overaggressive financing of the Postal Service Retiree Health Benefits Fund (PSRHBF) and the deepest downturn in economic activity since the Great Depression in the 1930's have contributed to significant downturns in mail volumes and revenues and have drained the Postal Service's cash availability to almost nothing. This is occurring despite the largest and most ambitious cost reduction effort in Postal Service history.

The climate for improvement in the largest part of the Postal Service's business, that of First-Class and Standard Mail, is bleak, and while Standard Mail volumes have the potential for recovering some of its lost volumes, the prospects for First-Class mail to recover any of the volume lost over the last four years is highly improbable. Also, despite its success at cost reductions and the increasing financial success of competitive products, it is nowhere near enough to offset the financial drain caused by the continuing decline of First-Class Mail.

The Postal Service is responding further to the financial crisis it is facing by proposing significant changes to its delivery schedule, retail and mail processing network, and employee benefits.[8] Many of these proposed changes are encountering resistance from our elected representatives and the public at large. Specifically, the Postal Service may not reduce the delivery schedule from six to five days without the Congress specifically changing the law. There is also significant political opposition to

[7] See Answer of the United States Postal Service to Parcel Shippers Motion, March 2, 2012 at 4 – 5.
[8] The Postal Service has proposed a five-year plan to reduce costs by $20 billion by FY 2015. http://about.usps.com/news/national-releases/2012/pr12_029.htm.

the Postal Service’s plans to consolidate and close half of its mail processing network. This same political opposition exists in the efforts to close over 3,000 post offices around the country, especially those in rural areas.

In response to the financial crisis facing the Postal Service, the Congress is proposing two radically different pieces of legislation to “reform” the Postal Service and its business model. The Senate version, S. 1789, would significantly alter the financing of the PSRHBF, allow the Postal Service to offer several other non-postal products, would delay any reduction in the number of delivery days by at least two years after enactment, and would significantly change the procedures for the closing or consolidating of any postal owned facility. The House of Representatives have a different version of postal reform in H.R. 2309. This legislation would create a “BRAC” like Commission to review and recommend changes in the retail and processing networks in addition to Area and District offices. The legislation would also not allow a reduction of delivery days, but would instead allow the Postmaster General to declare 12 “postal holidays” where delivery would be suspended. Also, the financing of the PSRHBF would be changed only slightly, reducing the amounts owed to the fund over the next two years, but significantly increasing them so that the total amount paid into the fund would not fundamentally change from what is required now.

What also is not known is how all these proposed changes, if any of them actually do occur, will affect the cost structure of the Postal Service going into the future. Many of these changes could have a profound effect on the current cost structure and the pool of institutional costs that are required to be recovered by the products and services. Until most of these questions are answered it will be premature to recommend any changes to the current appropriate share contribution of competitive products.

Recommendation

Because of the reasons noted above the Public Representative believes that no changes should be made to current Commission rule 3015.7(c). However, he also recommends that the Commission should maintain vigilance with regard to ensuring that competitive products continue to meet the appropriate share standard and that the Commission should reserve the right to institute another review before another five years goes by if the actual contribution of competitive products falls below the 5.5% threshold or significantly exceeds it by least 3 percent or more on a consistent basis.

Respectively Submitted

R. Kevin Harle
Public Representative